



Appeal of Ivan S. and Judith A. Fucilla

Appellants **Ivan S.** and Judith A. Fucilla resided in Los Altos, California, during the years in question. Ivan is a physician whose principal income **is** from salary paid to him by El Camino Radiologists Inc. Over the **years**, appellants have engaged in several real estate ventures. One of these ventures is at the root of this appeal.

In September 1967, appellants purchased a townhouse condominium on the west shore of Lake Tahoe **for** \$52,000. The lakefront townhouse has four bedrooms and two and one-half baths. It is located in a **residential** resort complex, known as Tahoe Taverns, which features several **recreational** facilities. These include a heated swimming pool, tennis courts, a private beach, boat docks, and a thousand-foot pier. By the end of 1974, the value of the townhouse had allegedly increased to \$79,000.

Since the purchase of the townhouse, appellants **have** continuously listed it for rental **with an on-the-premises**, professional management corporation which operates in conjunction with the resort's homeowners' association. The rental market at Lake Tahoe is year **round**, with the summer season running from mid-June to mid-September and the winter season running from **mid-September** to mid-June. Except for the two-week period **around Christmas and New Year's the summer season commands** a higher rental rate than the winter season. The management corporation advertises Tahoe Taverns as an entire resort complex, rather than advertising each condominium separately. The record contains a copy of some promotional literature for the resort, but does not reveal how the literature was distributed, nor whether any other means of advertising were utilized.

Although appellants' townhouse was continuously listed for rental, appellants had the right to request that the townhouse not be rented for certain periods so that they could use it themselves. In addition, they could also use the townhouse anytime it was not rented. They did, in fact, use the townhouse for personal recreational purposes. The following is a summary of the amount of time the townhouse has been rented, used by

Appeal of Ivan S. and Judith A. Fucilla

appellants, and vacant, to ~~the~~ extent that this information appears in the record: 1

Year	Days Rented	Days Used By Appellants	Days Vacant
1969	111	34	220
1970	104	28	233
1971	46	35	284
Totals	261	97	737

The information in the record for the years 1969, 1970, and 1971, indicates that appellants' personal use of the townhouse follows a fairly consistent pattern. In each of those years appellants used the townhouse for one week at Christmas and two weeks around the Fourth of July. They also used it for from one to three week-ends each winter and for one other week each year, either in the early spring or late summer. In 1971, this additional week included the Labor Day weekend.

On their California personal income tax returns for the years 1970, 1971, and 1972, appellants reported rental receipts from the townhouse as income. Appellants allocated a portion of the expenses incurred maintaining the townhouse to their personal use and deducted the balance as expenses incurred for the production of income. This resulted in a net loss for each year. The exact amounts for each year were as follows:

Year	Receipts Reported	Total Expenses	Expenses Deducted	Net Loss
1970	\$3,490.00	\$10,064.11	\$9,057.70	\$5,567.70
1971	2,830.05	10,270.72	9,644.96	6,814.91
1972	2,972.75	8,554.87	8,042.40	5,069.65
Totals	\$9, .8	28,889.70	\$26,745.06	\$17,452.26

1. The record in this area is incomplete. The years involved in this appeal are 1970, 1971, and 1972. However, the copy of appellants' schedule of rental and personal occupancy in the record covers the years 1969, 1970, and 1971. There is no indication in the record as to what the figures were for 1972. The schedule appears to contain several computational and other errors: however, it does show the exact dates on which the townhouse was rented or occupied by appellants. Since we believe the dates on the schedule are accurate, the actual number of days in each period is used in computing the figures in the summary.

Appeal of Ivan S. and Judith A. Fucilla

After an audit of appellants' returns for 1970, 1971, and 1972, respondent determined that appellants' ownership of the townhouse was not an activity engaged in for profit. Consequently, it disallowed the claimed expenses to the extent they exceeded the limitations imposed by section 17233 of the Revenue and Taxation Code. Appellants appealed this action, claiming the expenses were fully deductible under sections 17208 and **17252** of the Revenue and Taxation Code. In relevant part, these three sections are set forth in the margin. 2/

Focusing on subsection (c) of section 17233, the disposition of this appeal turns on the question of whether appellants' acquisition and holding of the townhouse was an activity engaged in for profit. In order

. Section 17233:

(a) **In the** case of an activity engaged in by an individual, if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed under this part except as provided in this section.

(b) **In the case of** an activity not engaged in for profit to which subsection (a) applies, there shall be allowed--

(1) The deductions which would be allowable under this **part** for the taxable year without regard to whether or not such activity is engaged in for profit, and

(2) A deduction equal to the amount of the deductions which would be allowable under this part for the taxable year only if such activity were engaged in for profit, but only to the extent that the gross income derived from such activity for the taxable year exceeds the deductions allowable **by** reason of paragraph (1).

(c) For purposes of this section, the term "activity not engaged in for profit" means any activity other than one with respect to which deductions are allowable under section 17202 or under subdivision (a) or (b) of section 17252.

(continued on next page)

Appeal of Ivan S. and Judith A. Fucilla

to prevail, appellants **must establish** that they **acquired** and held the townhouse primarily for profit-seeking purposes, and not primarily for personal recreational or other-nonprofit-purposes. (Joseph W. Johnson, Jr., 59 T.C. 791, 814 (1973); Benjamin Gettler, et al., T.C. Memo., March 31, 1975; Appeal of Clifford R. and Jean G. Barbee, Cal. St. Bd. of Equal., Dec. 15, 1976.)

Whether property is held for the primary purpose of making a profit is a question of fact on which the taxpayer bears the burden of proof. (Appeal of Clifford R. and Jean G. Barbee, supra.) The absence of a profit is not determinative, but the activity must be of such a nature that the taxpayer had a good faith expectation of a profit. (Carkhuff v. Commissioner, 425 F.2d 1400 (6th Cir. 1970); Joseph W. Johnson, Jr., supra.) Also, the taxpayer's expression of subjective intent is not controlling. Rather, the taxpayer's

2. (Continued)

Section 17208:

(a) There shall **be allowed** as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)--

* * *

(2) Of property held for the production of income.

Section 17252:

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year--

* * *

(b) For the management, conservation, or maintenance of property held for the production of income...

These sections are substantially identical to sections 183, 212, and 167, respectively, of the Internal Revenue Code of 1954.

Appeal of Ivan S. and Judith A. Fucilla

motives must be determined from all the relevant facts and circumstances. (Joseph W. Johnson, Jr., supra; Appeal of Clifford R. and Jean G. Barbee, supra.)

In support of their claim that the activity was engaged in for profit, appellants point to the nature of the activity and the manner in which they pursued it. They allege that their purchase of the townhouse should be viewed in conjunction with their other real estate investments and that these investments are part of an overall investment program, some aspects of which are more profitable than others. They also put a great deal of emphasis on the **fact** that they engaged the services of a professional management firm to handle the rental and they claim the townhouse was available for rental at all times. However, there is no indication that any of appellants' other real estate investments were resort properties or that appellants made personal use of any of the other properties. The mere fact that appellants hold other real estate for profit-seeking purposes does not mean that all their real estate is held for profit. And while listing the townhouse with the management firm certainly indicates a desire to rent it, this does not necessarily show an intention to earn a profit. It is equally indicative of an intent to earn sufficient income to minimize the cost of owning a resort home. (Appeal of John E. and Amet Z. Newland, Cal. St. Bd. of Equal., Sept. 17, 1975; Appeal of Clifford R. and Jean G. Barbee, supra.)

Our examination of the evidence leads us to conclude that appellants have not established that their primary purpose in acquiring and holding the townhouse was to earn a profit. Even though the rental receipts have been rather substantial, the expenses incurred to maintain the townhouse during the years on appeal were more than three times as great as the receipts during that period. We must assume that the losses from 1967 to 1969 were of the same magnitude. The record indicates that the townhouse continued to show a loss at least, through 1975. Further, the pattern of appellants' personal use shows they consistently used the townhouse themselves during peak holiday periods, when the rental market is the most lucrative. The large and continued losses and the pattern of appellants' use warrant an inference that they never had a good faith intention of realizing a profit from renting the townhouse. (Cecil v. Commissioner, 100 F.2d 896, 899 (4th Cir. 1939); Appeal of Clifford R. and Jean G. Barbee, supra.)

Appeal of Ivan S. and Judith A. Fucilla

Appellants argue that this cannot be the end of our **inquiry**. They insist that in deciding whether or not they had an intention of making a profit, we must also consider the production of prospective income resulting from the capital appreciation of the **townhouse**. While it is generally true that property held for capital appreciation can qualify as property "held for the production of income", (George W. Mitchell, 47 T.C. **120 (1966)**), this does not abrogate the taxpayer's burden of proving that the production of income was the primary purpose for holding the property.

In the instant case, there is sufficient evidence to show that appellants had a reasonable expectation that the townhouse would increase in value and that this expectation was one of the reasons for their purchase. (In fact, a person seldom, if ever, purchases real estate with the expectation of **losing** money.) However, the evidence also establishes that appellants had a second reason for buying the townhouse, that being their desire to use it for personal recreational purposes. When there are multiple purposes for the acquisition and holding of the property, the taxpayer's burden of proof requires that the taxpayer establish that the primary purpose was to make a profit. (Carkhuff v. Commissioner, *supra*; Appeal of Clifford R. and Jean G. Barbee, *supra*.) Appellants have introduced no evidence to prove that the intent to make a profit was their primary purpose for acquiring and holding the townhouse.

Appellants having failed to meet their burden of proving that the activity was engaged in for profit, the deduction of the expenses related to the townhouse is subject to the limitations imposed by section 17233.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

Appeal of Ivan S. and Judith A. Fucilla

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Ivan S. and Judith A. Fucilla against proposed assessments of additional personal income tax in the amounts of \$113.53, \$212.58, and \$164.45 for the years 1970, 1971, and 1972, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 2nd day of March, 1977, by the State Board of Equalization.

Sheldon G. Blumenthal Chairman
Charles H. Harty, Member
Philip H. Harty, Member
_____, Member
_____, Member

ATTEST:

W. W. Dunlop, Executive Secretary